

CALIFORNIA STATE TEACHERS' RETIREMENT BOARD

INVESTMENT COMMITTEE

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SUBJECT: Fixed Income -  
Liquidity Policy

ITEM NUMBER: 10

ATTACHMENT(S): 2

ACTION: X

DATE OF MEETING: April 7, 1999

INFORMATION: \_\_\_\_\_

PRESENTER(S): Ms. Cunningham

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**EXECUTIVE SUMMARY**

One of the 1998/99 objectives approved for the Investment Branch is to review each of the policies to ensure completeness and consistency, with revisions to be made as necessary.

Attachment 1 represents the Liquidity Portfolio Policy Manual, which outlines the policies of CalSTRS' internally managed short-term fixed income portfolio, also known as the Liquidity Portfolio. The Liquidity Portfolio provides cash flow for the System for such purposes as funding benefit payments, investment manager activity, and asset allocation. Previously, the Liquidity Portfolio policies had been included within the Fixed Income Policy Manual. However, it has been separated in order to be consistent with the other portfolios and programs managed within the Investment Branch.

The Liquidity Policies have been designed to set the boundaries that will ensure prudence and care in the management of the Liquidity Portfolio, while allowing sufficient flexibility in the management process to capture investment opportunities. Also included is a flow chart in order to provide the context for the policies within the general process of the management of the cash flow needs of the System. The policies are intended to be static in nature and will be returned to the Investment Committee prior to changes being implemented.

**RECOMMENDATION**

Staff and Pension Consulting Alliance recommend that the Investment Committee approve the Liquidity Policy Manual by adopting the attached resolution (Attachment 2).

# **CalSTRS**

## **CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM**

### **LIQUIDITY PORTFOLIO POLICY MANUAL**

**INVESTMENT BRANCH**  
**April, 1999**

**California State Teachers’ Retirement System**  
**Liquidity Portfolio Policy Manual**

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# **California State Teachers' Retirement System**

## **Liquidity Portfolio Policy Manual**

### **INTRODUCTION**

The California State Teachers' Retirement System's (CalSTRS, System) short-term fixed income portfolio, also known as the Liquidity Portfolio, provides cash flow for the System for such purposes as funding benefit payments, investment manager activity, and asset allocation. In managing the Liquidity Portfolio, the System employs a number of professional money management techniques and strategies. These techniques and strategies include varying the composition of the portfolio's assets and the average maturity of the portfolio, based upon an assessment of the relative values of the various short-term fixed income securities, and future interest rate patterns which result from changing economic conditions and shifts in fiscal and monetary policy.

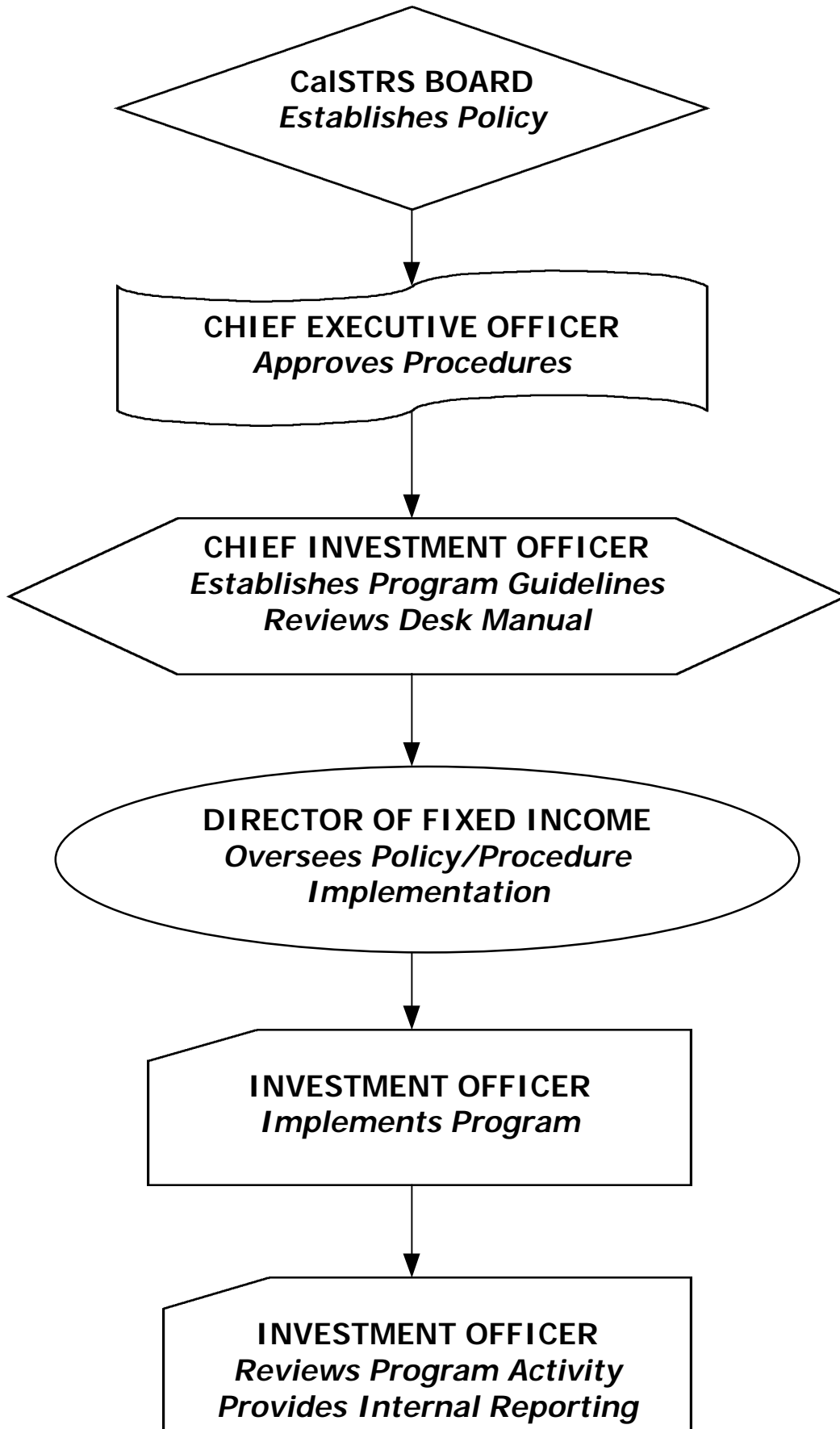
The Liquidity Portfolio invests in a wide range of dollar denominated securities including, but not limited to:

- U.S. Treasury Bonds/Notes/Bills
- U.S. Agencies/Discount Notes
- U.S. Government-Sponsored Corporations
- U.S. Corporate Bonds, Notes and Medium Term Notes
- U.S. Money Market Securities (Commercial Paper, B/A's, Repo's, etc.)
- Private Placements
- Asset-Backed Securities
- Floating Rate Securities
- Mortgage-Backed Securities
- U.S. Dollar Bonds/Money Market Securities issued by foreign borrowers (Yankees)
- U.S. Dollar Bonds/Money Market Securities issued outside the U.S. (Eurodollars)

These short-term fixed income securities are managed internally by Investment Officers - Fixed Income, under the direction of the Director of Fixed Income, within the asset allocation and strategic objectives established by the Board.

This policy document outlines the approved policies of CalSTRS' internally managed Liquidity Portfolio, and has been designed to ensure prudence and care in the management of the Liquidity Portfolio while allowing sufficient flexibility in the management process to capture investment opportunities. A flow chart is included to provide the context for the policies within the general process of the management of the cash flow needs of the System. Words and terms that may be unfamiliar to the reader are referenced in the Glossary.

# LIQUIDITY PORTFOLIO FLOWCHART



**California State Teachers' Retirement System  
Liquidity Portfolio Policy Manual**

**LIQUIDITY PORTFOLIO POLICIES**

**April 1999**

The following represent the approved policies to be utilized in the management of the Liquidity Portfolio. These policies are designed to set boundaries that will ensure prudence and care in the management of the Liquidity Portfolio, while allowing sufficient flexibility in the management process to capture investment opportunities. Policies approved by the CalSTRS Board cannot be altered without explicit direction from the CalSTRS Board.

1. Laws and Statutes - The System's Liquidity Portfolio is to be invested in a prudent manner for the sole benefit of its participants and beneficiaries, in accordance with the Teachers' Retirement Law and other applicable statutes. No investment instrument or activity prohibited by the Investment Resolution adopted by the Board in 1984, as amended from time to time, shall be authorized for the Liquidity Portfolio.
2. Investment Objective – The investment objective for the Liquidity Portfolio is to seek the preservation of capital and liquidity, and to generate the highest possible current income consistent with a prudent level of risk available from investing in a diversified portfolio of short-term fixed income securities.
3. Diversification - Diversification within investment portfolios is critical in order to control risk and maximize returns. Minimum and maximum ranges, with respect to investment types, credit exposure, and investment maturity, shall be established for the Liquidity Portfolio. Such ranges shall be documented within the Procedures Manual and are subject to change as conditions warrant, as determined by the Director of Fixed Income.
4. Trade Execution – Investment Officers are to use their best efforts and discretion at all times in order to obtain the most favorable trade execution possible for the System. Competitive bids/offers are encouraged for all portfolio transactions. However, there are circumstances that preclude the competitive process during trading. Such exceptions are to be documented on the trade ticket, with the statistics associated with trading activity included in the monthly Liquidity Portfolio report.
5. Authorized Signers – Authorization letters which indicate who may transact business for the CalSTRS Liquidity Portfolio shall be sent with a copy of the most recent Investment Resolution, initially at the time an account is opened and then periodically to all fixed income broker/dealers with whom CalSTRS conducts business. Whenever a change in authorized signers takes place, the broker/dealers shall be notified in writing within 24 hours, in the event of termination, and as soon as possible, in the event of a newly authorized signer(s).
6. Authorization Limits – No daily limits with respect to the approval of trade activity within the Liquidity Portfolio shall be established.

7. Trade Processing – Prior to being processed to Operations, all trade tickets shall be authorized and countersigned by two Investment Officers within Fixed Income.
8. Business Plan – The Liquidity Portfolio will be managed in accordance with an annual Business Plan, which will include a broad overview of the asset class, along with the key issues associated with the management of the portfolio and future objectives and a resource allocation study.
9. Delegation of Authority – The management of CalSTRS' Liquidity Portfolio is delegated to staff within the boundaries established by these policies and the processes described within the Procedures Manual.
10. Reporting – Staff will prepare a monthly report for the Chief Investment Officer, which summarizes the activities associated with the management of the Liquidity Portfolio. The report shall provide information regarding portfolio performance, risk characteristics, and trade execution summaries.
11. Board Review – The Board shall administer and review this policy periodically, as it deems appropriate and in keeping with the investment standard.

**California State Teachers' Retirement System  
Liquidity Portfolio Policy Manual**

**GLOSSARY**

**AGENCY SECURITIES** - Investments issued by federal corporations and federally sponsored corporations that are able to issue debt at a lower cost to such constituencies as farmers, homeowners, and students.

**ASSET-BACKED SECURITIES** - Investments that are collateralized by assets such as automobile loans, agricultural equipment loans, and credit card loans. The loans feature credit enhancements that lead to high credit ratings and limited investor exposure to the credit of the seller.

**BANKERS' ACCEPTANCES** - Time drafts drawn on and accepted by a bank within one to six months. They are used to provide manufacturers and exporters with capital to operate between the time of manufacturing (or exporting) and payment by purchasers.

**BASIS POINT** - One hundredth of one percent; .0001 in decimal form.

**CASH FORECAST** - The projection provided by CalSTRS' Operations division of the sources and uses of cash for the System in the immediate future.

**CERTIFICATE OF DEPOSIT (CD)** - A negotiable security issued by commercial banks against money deposited with them for a specified period of time. CDs pay interest at either a fixed or floating rate, periodically or at maturity, and the principal when it reaches final stated maturity.

**COLLATERAL** - Securities and other property pledged by a borrower to secure payment of a loan.

**COMMERCIAL PAPER** -Unsecured, short term (usually a maximum of nine months) bearer obligations with denominations in multiples of \$100,000.00, issued principally by industrial corporations and finance companies; usually issued at a discount from face value.

**COMPETITIVE BIDS** - The practice of soliciting more than one bid or offer for a security transaction. It is based on an identifiable asset in accordance with identified fixed rules for all participants.

**CORPORATE BOND** - A financial obligation for which the issuer, a company, promises to pay the bondholders a specified stream of cash flows, including periodic interest and a principal repayment.

**CREDIT RATING** - A relative ranking of timely interest payment and principal repayment based on past records of debt repayment, current financial status, and future outlook for the company.



**DISCOUNT NOTE (AGENCY)** - An obligation of a federal corporation or a federally sponsored corporation issued at a discount to par value, usually less than one year to maturity.

**DURATION** - The weighted average maturity of the present value of a bond's cash flow stream. A measure of the change in price for a small movement in interest rates.

**EURO-DOLLAR DEPOSITS** - Certificates of deposit issued by banks outside of the United States, with interest and principal paid in dollars.

**FAILED TRADE** - Purchased or sold investment securities that are not delivered on the contracted settlement date.

**INDEX** - A defined representative collection of securities used to measure the change in value of the securities market on a monthly basis.

**INDEXED PORTFOLIO** - Contains a core portfolio of United States Treasury issues, mortgage-backed securities, and corporate securities.

**INVESTMENT OFFICER** - Any one of the CalSTRS in-house investment professionals in the CalSTRS Fixed Income unit.

**LIQUIDITY** - The ease with which a bond can be purchased or sold at a fair price in a timely manner.

**LIQUIDITY PORTFOLIO** - For CalSTRS' purposes, this is the short-term fixed income portfolio that provides cash flow for funding transactions for the System, such as benefit payments, investment manager activity, and asset allocation. Examples of short-term investments include U.S. Treasury, Agency, and money market securities (commercial paper, certificates of deposit, Euro-dollar deposits, repurchase agreements).

**MEDIUM TERM NOTE** - Medium Term Notes (MTNs) are corporate or agency debentures. They differ from traditional underwritten corporate bonds only in the process by which they are issued. MTNs typically are offered on a periodic or continuous basis through one or more managers acting as agents.

**MORTGAGED-BACKED SECURITY (MBS)** - A security that is issued by a federal agency, such as the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, or the Government National Mortgage Association that is backed by mortgages. Payments to investors are received out of the interest and principal of the underlying mortgages.

**MOTIVATION** - The force, intent, or impulse that causes the Investment Officer to approach a transaction or series of transactions in a particular way.

**PAR VALUE** - The underlying stated value of a bond. The par value serves as the basis for calculating coupon payments and settlement details.

**PORTFOLIO** - A collection of stocks, bonds or money market securities owned by an investor and segmented by a predefined method.

**POSITION** - The status of securities, futures, and options in an account - long or short.

**PRINCIPAL PAYDOWN** - The portion of a periodic payment that reduces the amount of the principal.

**PRIVATE PLACEMENT** - The purchase of a security directly from the issuing corporation.

**QUALITY RANGES** - Guidelines for the percentage of market value of a particular credit rating within a portfolio.

**RATE OF RETURN** - The total income received over a period of time, including interest income, accretion of discount, amortization of premium and change of market value; usually expressed as a percentage or in decimal format.

**REALIZED LOSS** - The excess of a bond's book value on the date of sale over the sale's proceeds.

**REPURCHASE AGREEMENT (REPO)** - An arrangement or contract with a dealer to purchase a government, agency or other security at a fixed price, with provisions for its resale at the same price at a rate of interest determined competitively.

**SETTLEMENT DATE** - For each security transaction, a price is established based on the specifics of the security and the payment date. The payment date, or when the security is exchanged for value, is called the settlement date.

**SHELF REGISTRATION** - The maximum amount of a medium term note issue.

**SINKING FUND** - The periodic retirement of a portion of a principal amount of a bond issue. A pre-specified schedule determines the timing and the amount of the sinking fund payments.

**SPLIT-RATED** - The credit ratings of corporate and other securities are made by independent services such as Moody's or Standard & Poors. When a security receives ratings that are different among the rating services, the term split-rated is used to signify this difference in relative credit ratings.

**TRACKING ERROR** - The deviation of the portfolio's rate of return from that of the target index or management criteria.

**UNITED STATES TREASURY SECURITIES** - Debt issues of the U.S. Government, such as Treasury bills, notes and bonds.

**WHOLE LOANS** - A secondary mortgage market term which refers to an investment in an original mortgage loan, versus a loan which participates in a secured pass-through security.

PROPOSED  
RESOLUTION OF THE  
CALIFORNIA STATE TEACHERS' RETIREMENT BOARD  
INVESTMENT COMMITTEE

SUBJECT: Liquidity Portfolio Policies

Resolution No. \_\_\_\_\_

WHEREAS, the Investment Committee of the California State Teachers' Retirement Board is responsible for recommending to the Board, investment policy and overall investment strategy; and

WHEREAS, the Investment Committee has received and reviewed the Liquidity Portfolio Policies and has heard oral presentations from Staff; and

WHEREAS, the Staff has recommended the adoption of the Liquidity Portfolio Policies; Therefore be it

RESOLVED, that the Investment Committee of the California State Teachers' Retirement Board adopts the Liquidity Portfolio Policies.

Adopted by:  
Investment Committee  
on \_\_\_\_\_

\_\_\_\_\_  
James D. Mosman  
Chief Executive Officer